

May 22, 2014

Gerard Poliquin
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Re: Comment on the Proposed Rule, Prompt Corrective Action – Risk Based Capital Regulation

Dear Mr. Poliquin:

As the Chief Executive Officer of Desert Schools Financial Services, LLC; (DSFS) a credit union service organization (CUSO) and wholly owned subsidiary of Desert Schools Federal Credit Union located in Phoenix, Arizona (Desert Schools), I appreciate the opportunity to comment on the National Credit Union Administrations (NCUA's) recent proposed rule, Prompt Corrective Action – Risk Based Capital issued on January 23, 2014 (Proposed Rule).

DSFS commends the NCUA for taking what it views as a positive first step toward improving the existing risk-based net worth standard for credit unions.

However, on behalf of our CUSO, DSFS would like to respectfully address the following concerns and is hopeful that the NCUA will modify or remove certain elements from the final regulation.

DSFS' primary concern stems from the risk weighting of 250% assigned in the Proposed Rule to investments in CUSOs which is arbitrary, punitive and not supported by any empirical data. If the expectation of a credit union is to successfully compete with other financial institutions to be their members' primary financial institution, a credit union must have the opportunity to provide a full array of financial products and services through a CUSO. By offering more products and services, the Credit Union – CUSO combination permits many opportunities to innovate, collaborate, compete, cross-sell and generate additional efficiencies and revenue in

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order to obtain more financial business from credit union members. CUSOs have been used for many years to reduce costs and generate income while providing meaningful and necessary services to members. Profitability studies validate that the more services a member has with a CUSO, the more profitable they are to the credit union as a whole. In our case, 245,538 members have an average annual household profitability of \$259 and an average of 2.561 services per household with credit union only services. Profitability to the credit union increases as follows:

- \$394 and 3.337 services per household if they have an investment account through DSFS;
- \$453 and 3.243 services per household if they have insurance products through DSFS;
- \$495 and 3.657 services per household if they have their estate planning documents prepared through DSFS.

Please consider that not all CUSOs pose systemic risk to their credit unions. DSFS believes that only a handful of CUSOs created losses which impacted NCUSIF and that they are the basis for NCUA's perceived lack of confidence in all CUSOs. The reality is there are hundreds of CUSOs that like DSFS, are performing, are well managed and have a profound and meaningful impact to the members of their parent credit unions. DSFS asks that the NCUA take the time to appreciate the overwhelming positive impact CUSOs have in the lives of credit union members and the positive financial impact they have to their parent credit unions.

NCUA recently published a rationale for its revised CUSO regulation in the Federal Register¹ that might prove useful in demonstrating how the NCUA could apply the various risk-weights to investments in different CUSOs. The rationale stated:

*"In light of the comments received on the proposed rule, the Board has determined to significantly reduce the scope and application of the reporting requirement in the final rule. Accordingly, the final rule narrowly focuses on CUSOs engaging in certain **complex or high-risk** activities. The Board notes that the types of activities qualifying as complex or high-risk, as well as the reporting requirements for CUSOs engaging in such activities, may evolve as new risks emerge. At this time, however, the Board believes that for purposes of the reporting requirement, complex or high-risk activities include credit and lending, information technology, and custody, safekeeping, and investment management services for credit unions because these particular activities tend to affect a large number of credit unions and present a high degree of operational and/or financial risk. Activities related to these categories currently include:*

¹ Vol. 78, No 232/Tuesday, December 3, 2013/Rules and Regulations, 72542

- *Credit and lending –*
 - *Business loan origination;*
 - *Consumer mortgage loan origination;*
 - *Loan support services, including servicing;*
 - *Student loan origination; and*
 - *Credit card loan origination.*
- *Information and technology –*
 - *Electronic transaction services;*
 - *Record retention, security, and disaster recovery services; and*
 - *Payroll processing services.*
- *Custody, safekeeping, and investment management services for credit unions*¹⁸

DSFS requests that the NCUA consider applying a less stringent standard for all CUSOs, especially those which do not engage in **complex or high-risk** activities. The standard should be consistent with other provisions within the Proposed Rule. The current CUSO regulation already limits the exposure to the credit union for their loan and/or investment in a CUSO, requires an attorney opinion letter supporting the risk analysis and requires a written agreement between the credit union and the CUSO. Further, when comparing the proposed risk-weight of 250% versus other asset classes, such as a member business loan with a 7-year balloon maturity (assuming the portfolio represents <15% of total assets) carrying a risk-weight of 100% seems inconsistent. The minimal amount of risk represented in DSFS is an example of this inconsistency.

Of further concern is the 250% risk-weight based upon the current value of the CUSO investment, rather than the **initial** investment. This approach will penalize a successful CUSO and will inhibit their growth and success. It will punish the CUSO for growing which seems to be an unintended consequence of the proposal.

The rationale for the revised CUSO regulation² further states: *“At present, NCUA cannot fully determine the total number of CUSOs that presently exist, which CUSOs maintain relationships with which credit unions, the financial condition of CUSOs, or the full range of services offered by CUSOs.”* DSFS supports the NCUA’s attempt at enhancing the reporting requirements in the new CUSO rule.

¹⁸*CUSOs only engaging in trust services for individual credit union members will be required to submit only basic profile information. These CUSOs will not be required to submit the additional, enhanced report.”*

² Vol. 78, No 232/Tuesday, December 3, 2013/Rules and Regulations, 72542

DSFS respectfully recommends that before an onerous standard is established, NCUA take the time to gather the information through the new reporting requirements for CUSOs and then respond to the actual risk rather than the perceived risk. The proposed implementation date under the Proposed Rule is eighteen months after final passage. DSFS suggests that a longer implementation plan be considered so that factual, empirical data can be sufficiently gathered before the NCUA acts or publishes the final rule.

DSFS urges the NCUA to consider that the Proposed Rule will:

1. Impede the ability of CUSOs to innovate and provide collaborative solutions that will sustain credit unions;
2. Discourage the growth of existing CUSOs and the formation of new CUSOs and inhibit or discourage credit unions from investing in CUSOs;
3. Take a one-size fits all approach to the risk without consideration of empirical data, the type of services provided by the CUSO, and determining where the significant risks really exist;
4. Penalize the investing credit union for the growth and success of the CUSO beyond their initial investment which will harm members and will create an uneven playing field with our banking counterparts.

In closing, thank you for the opportunity to comment on the Proposed Rule and for considering DSFS's positions.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Becky L. Nilsen", written in a cursive style.

Becky L. Nilsen
Chief Executive Officer